

This letter concerns the taxability of RFID ear tags and ear tag applicators used in production agricultural. See 86 Ill. Adm. Code 130.305. (This is a GIL.)

December 31, 2007

Dear Xxxxx:

This letter is in response to your letter dated June 21, 2007, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

Please accept this letter, on behalf of our client, as an official request for ruling regarding the state sales & use taxability of the products and services they sell. ABC is in the business of providing data collection and data management services to the food producing, processing, and purveying industries (primarily beef and dairy). ABC has built, or has access to, technologies that aid in the collection of data on an individual unit or group basis, allow that data to be linked up and down the food supply chain process the data for value-added decisions throughout the supply chain. Their products and services are essential in assisting their customers in meeting federal (USDA) & state compliance regulations.

The basis of their data collection and management services is a radio frequency electronic ear tag (RFID) that is applied to an animal's ear for identification purposes. These tags contain a unique identification number that will specifically identify the animal in our database. Once an animal is tagged any amount and type of data can be specifically associated with the animal's unique identifying number. Pursuant to this identification system they provide the following standard services:

The ABC System-1 is a comprehensive decision support platform that supports the National Animal Identification System (NAIS). The NAIS is a voluntary, modern, streamlined information system provided by the United States Department of Agriculture (USDA) that helps producers and animal health officials respond quickly and effectively to animal health events in

the United States. ABC-SYSTEM-1 is an online subscription based service that provides for the location identification of tagged animals.

The ABC SYSTEM-2 is a multi-species animal tracking system that supports the NAIS mandatory movement requirements. ABC System-2 is an online subscription based service that provides for the tracking of where a tagged animal has been.

The ABC SYSTEM-3 is a comprehensive system that stores and processes information for age, process, source and movement verification that can be presented in a customized certificate format. ABC System-3 is an online subscription based service that provides for the verification of age, process, source, and movement of tagged animals as necessary per USDA requirements.

The SYSTEM-4 is [sic] data management tool that certifies traditional health processes and verifies age, source and movement of individual cattle. The SYSTEM-4 is a USDA Process Verified Program (PVP) meaning that it has been evaluated and approved by the USDA Agricultural Marketing Service (AMS) Audit, Review and Compliance (ARC) Branch. A producer who receives PVP approval is allowed to use the USDA Process Verified Program shield which testifies to the quality of their product. A producer using the SYSTEM-4 provides records of its calves to a SYSTEM-4 facilitator (i.e. a veterinarian). The facilitator then enters the records into the SYSTEM-4 electronic data warehouse. When the calves are ready for market, the facilitator prints and signs a SYSTEM-4 certificate or the facilitator can electronically remit the records to the next owner. In order to participate in the SYSTEM-4 PVP, specific requirements must be met to insure that animals are properly identified and the necessary records for these animals are maintained. The SYSTEM-4 is an online subscription based service.

In light of the above, we request a written response as to the sales & use taxability of the following sales of products and services:

- 1) Identification Ear Tags (RFID);
- 2) Identification Ear Tag Applicator (Device used to apply the identification ear tags to an animal);
- 3) Replacement Pins (Replacement parts for the ear tag applicator);
- 4) Online Subscription Charges for ABC SYSTEM-1, ABC SYSTEM-2, ABC SYSTEM-3, and SYSTEM-4 as described above;
- 5) USDA Certificate Fee (A charge for a paper certificate certifying that USDA requirements have been met);
- 6) Audit Certification Fee (A consulting fee for verifying that a program will meet USDA PVP requirements);

- 7) Custom Development Fee (Consulting fees for development of custom reports/programs);
- 8) Training Fees;

To aid in your analysis we have included copies of various marketing brochures. In addition, please note our client's website. If you should require any additional information please do not hesitate to call me.

DEPARTMENT'S RESPONSE:

Your letter and the attachments do not provide sufficient information to determine whether the Company identified in your letter has nexus in the State of Illinois. Whether a company has nexus affects a company's Illinois tax obligations. The Department declines to make nexus determinations in the context of Private Letter Rulings or General Information Letters because the amount of information required to make such determinations is often best gathered by an auditor. However, the following information outlines the principles of nexus. We hope it is helpful to you in determining your Company's tax obligations.

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See 86 Ill. Adm. Code 130.101. In Illinois, Use Tax is imposed on the privilege of using, in this State, any kind of tangible personal property that is purchased anywhere at retail from a retailer. See 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois.

An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i). This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The United States Supreme Court in *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992), established the current guidelines for determining the nexus requirements that must be met before a person is properly subject to a state's tax laws. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails himself or itself of the benefits of an economic market in a forum state. *Quill* at 1910. The second prong of the Supreme Court's nexus test requires, if due process requirements have been satisfied, that the person or entity have a physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller. The representative need not be a sales representative. Any type of physical presence in the State of Illinois, including the vendor's delivery and installation of his product on a repetitive basis, will trigger Use Tax collection responsibilities. Please see *Brown's Furniture, Inc. v. Wagner*, 171 Ill.2d 410, (1996).

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax liability on the purchase of the goods and have a duty to self-assess and remit their Use Tax liability directly to the State. In such instances, those customers must remit their Illinois Use Tax along with a completed Form ST-44, Illinois Use Tax Return, unless they are otherwise registered or are required to be registered with the Department and remit their Illinois Use Tax with a Form ST-1, Illinois Sales and Use Tax Return. Many retailers that do not have nexus with the State have chosen to voluntarily register as Use Tax collectors as a courtesy to their Illinois customers so that those customers are not required to file returns concerning the transactions with those retailers.

Illinois Retailers' Occupation and Use Taxes do not apply to sales of service that do not involve the transfer of tangible personal property to customers. However, if tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. For your general information see of 86 Ill. Adm. Code 140.101 through 140.109 regarding sales of service and Service Occupation Tax.

We are unable to determine if the transfer of ear tags, applicators and replacement pins are retail sales or are being transferred incident to the sale of a service. Illinois sales tax does not apply to the sale of machinery and equipment, both new and used and including that manufactured on special order, used or leased for use primarily in production agriculture or for use in State or Federal agricultural programs. See 86 Ill. Adm. Code 130.305. The sale of individual replacement parts for such machinery and equipment is also exempt. In order to obtain the exemption, the purchaser must certify to the use of the equipment or machinery primarily in production agriculture. Production agriculture includes the raising of or the propagation of livestock. Equipment means any independent device or apparatus separate from any machinery, but essential to production agriculture, including microchips and sensors to identify specific animals. 86 Ill. Adm. Code 130.305(k). RFID ear tags and the ear tag applicators that are used primarily (over 50% of the time) in production agriculture qualify for the exemption.

Under the Service Occupation Tax Act, businesses providing services (*i.e.* servicemen) are taxed on tangible personal property transferred as an incident to sales of service. See 86 Ill. Adm. Code 140.101. The purchase of tangible personal property that is transferred to the service customer may result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. The serviceman's liability may be calculated in one of four ways: (1) separately-stated selling price of tangible personal property transferred incident to service; (2) 50% of the servicemen's entire bill; (3) Service Occupation Tax on the servicemen's cost price if the servicemen are registered *de minimis* servicemen; or (4) Use Tax on the servicemen's cost price if the servicemen are *de minimis* and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is then calculated on the separately-stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred. See 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to *de minimis* servicemen who have either chosen to be registered or are required to be registered because they

incur Retailers' Occupation Tax liability with respect to a portion of their business. See 86 Ill. Adm. Code 140.109. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis. Registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations. Such servicemen also collect a corresponding amount of Service Use Tax from their customers, absent an exemption.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers. See 86 Ill. Adm. Code 140.108.

If the services involve the transfer of tangible personal property (even written reports, other tangible media and training manuals) incident to a sale of service the serviceman would be subject to liability under one of the four methods described above.

We are unable to determine if you are providing software or telecommunications services. Generally, sales of "canned" computer software are taxable retail sales in Illinois. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See Section 130.1935(c). Custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See Section 130.1935(c)(3). If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software or the subsequent software updates will be subject to Retailers' Occupation Tax.

Charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under Section 130.1935(c), they may not be taxable. But, if maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the whole agreement would be taxable as sales of canned software. Please note that information or data that is electronically transferred or downloaded is not considered the transfer of tangible personal property in this State. See 86 Ill. Adm. Code 130.2105(a)(3). However, canned computer software is considered tangible personal property regardless of the form in which it is transferred or transmitted, including tape, disc, card, electronic means or other media. See 86 Ill. Adm. Code 130.1935. If computer software training or other support services are provided in conjunction with a sale of custom computer software or a license of computer software, the charges for that training are not subject to tax.

The Telecommunications Excise Tax Act imposes a tax upon the act or privilege of originating or receiving intrastate or interstate telecommunications in Illinois at the rate of 7% of the gross charges for such telecommunications purchased at retail from retailers. "Telecommunications" does not include "charges for the storage of data or information for subsequent retrieval or the processing of data or information intended to change its form or content" or "value-added services in which

computer processing applications are used to act on the form, content, code and protocol of the information for purposes other than transmission." Charges for access to an on-line computer database fall within this category. Charges for data processing and information retrieval also are generally not taxable, but charges, if any, for transmission of the data are generally taxable. See 86 Ill. Adm. Code 495.100(c).

If retailers provide both transmission and data processing services, the charges for each must be disaggregated and separately stated from telecommunications charges in the books and records of the retailers. If these charges are not thus disaggregated, the entire charge is taxable as a sale of telecommunications. Generally, persons that provide subscribers access to the Internet and who do not, as part of that service, charge customers for the line or other transmission charges that are used to obtain access to the Internet are not considered to be telecommunications retailers.

I hope this information is helpful. If you require additional information, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

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Associate Counsel

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